No. 06-760

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In The

Supreme Court of the United States

KATHI COOPER, et al.,

Petitioners,

v.

IBM PERSONAL PENSION PLAN & IBM CORP.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY TO BRIEF IN OPPOSITION

RICHARD J. LAZARUS
600 New Jersey Ave., N.W.
Washington, D.C. 20001

DOUGLAS R. SPRONG
STEVEN A. KATZ
KOREIN TILLERY, LLC
Gateway on the Mall
701 Market St., Suite 300
St. Louis, MO 63101

WILLIAM K. CARR
LAW OFFICES OF WILLIAM CARR
222 East Tennessee Ave.
Denver, CO 80209

LEE A. FREEMAN, JR.*
JAMES T. MALYSIAK
FREEMAN, FREEMAN
& SALZMAN, P.C.
401 North Michigan Ave.
Suite 3200
Chicago, IL 60611
(312) 222-5100

ROBERT F. HILL
JOHN H. EVANS
HILL & ROBBINS, P.C.
100 Blake Street Building
1441 Eighteenth St.
Denver, CO 80202

Counsel for Petitioners

**Counsel of Record*

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

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REPLY TO BRIEF IN OPPOSITION

IBM's Brief in Opposition (1) concedes that the Seventh Circuit's decision is of paramount national importance because it directly affects the pension benefits of the ten million employees and retirees who participate in cash balance plans; (2) contradicts Judge Easterbrook's holding that cash balance plans and defined contribution plans are economically equivalent; (3) abandons Judge Easterbrook's construction of ERISA's provisions prohibiting age discrimination in pension benefit accrual; and (4) admits that in the few months since the decision below federal district courts have reached diametrically opposed holdings on the core question presented by the Petition: whether cash balance plans violate ERISA Section 204(b)(1)(H)(i) by reducing an employee's rate of benefit accrual based on age.

With respect to the second issue raised by the Petition – whether IBM violated Section 204(b)(1)(H)(i) by using the Always Cash Balance transitional formula favoring younger employees when it adopted a cash balance plan – IBM provides no justification or authority supporting the Seventh Circuit's holding that increasing younger workers' benefits does not violate older workers' rights under ERISA provided that their benefits are not diminished.

I. IBM FAILS TO DEFEND THE SEVENTH CIRCUIT'S MISCONSTRUCTION OF SECTION 204(b)(1)(H)(i).

A. IBM's Brief in Opposition fails to defend – indeed, completely ignores – the centerpiece of Judge Easterbrook's opinion for the Seventh Circuit: its holding that the provisions prohibiting age discrimination in benefit accrual in defined benefit and defined contribution plans are identical despite their radically different terms. Pet. App. 2. This supposed equivalency provided Judge Easterbrook with a statutory basis for ignoring the admittedly

discriminatory rate of benefit accrual under cash balance plans as workers approach normal retirement age.

The foundation for Judge Easterbrook's equivalency holding was his view that cash balance plans and defined contribution plans are economically indistinguishable. However, IBM's Brief in Opposition rejects economic equivalence. IBM says merely that cash balance plans "resemble" defined contribution plans but lack the two core characteristics of such plans: "an employee's benefit does not depend on the plan's investment performance or on the contributions made to the plan." Br. Opp. 3.

IBM's repudiation of Judge Easterbrook's holding of statutory equivalence is consistent with its arguments below. In its Seventh Circuit Reply Brief, IBM conceded that the standards in ERISA Section 204(b)(1)(H)(i) and (b)(2) are different in substance and that discriminatory benefit accrual in cash balance plans is not determined, as Judge Easterbrook subsequently held, by hypothetical contributions to a fictional account but instead by whether the cash balance benefit formula results in a reduction in benefit accrual as the worker's age increases.[1]

However, by distancing itself from Judge Easterbrook's statutory misconstruction, IBM has no statutory support for its alternative arguments defending the

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[1] Here is what IBM said below:

"IBM's construction of § 204(b)(1)(H) dovetails with the statutory distinction between defined benefit plans and defined contribution plans. Defined contribution plans provide a benefit based on contributions and investment returns allocated to individual accounts; Congress therefore subjected such plans to an age discrimination requirement that focuses on the allocations to an employee's account. 29 U.S.C. § 1054(b)(2). Defined benefit plans, by contrast, provide benefits prescribed by a benefit formula; § 204(b)(1)(H) therefore subjects these plans to an age discrimination requirement that focuses on the plan's benefit formula." IBM's 7th Cir. Reply Br. 8.

Seventh Circuit result though not its reasoning. IBM contends that "rate of an employee's benefit accrual" in Section 204(b)(1)(H)(i) cannot "sensibly" refer to "accrued benefit," defined by ERISA for defined benefit plans to mean an employee's annuity at normal retirement age, because that would ignore the "time value of money." But there is nothing in ERISA that justifies discriminatory benefit accrual because of the "time value of money." In contrast, ERISA's defined benefit provisions are focused on the promised annuity at normal retirement age because that benefit is intended to provide the employee's support in retirement. "Rate of an employee's benefit accrual" could not "sensibly" refer to anything else, certainly not to the cash balance plan's hypothetical constructs of "account balance" and "interest credits" which are not even mentioned in ERISA and have no economic reality.[2]

IBM tries to knock down a strawman by contending that plaintiffs assert that the mere payment of interest in a cash balance plan violates Section 204(b)(1)(H)(i). Br. Opp. 11. First, no "interest" is actually paid in a cash balance plan. Second, it is not the payment of interest that is illegal, but instead IBM's guarantee of higher benefits to younger workers at normal retirement age based on the greater number of "interest credits" that younger workers will receive through the cash balance formula than similarly situated older workers. Those higher benefits are entirely the result of age – the number of years the employee has until reaching normal retirement age (65 in IBM's Plan). A 45-year-old worker will receive 20 years of such "interest credits" under the formula while a

[2] IBM's Brief in Opposition (at 3) treats the cash balance "account," "pay credits," and "interest credits" as having economic reality when they are fictions having no substance. IBM's Plan acknowledges that these are mere hypothetical constructs. *See* Petition at 20 n.3.

55-year-old with the same service and salary history will receive only 10 years of "interest credits."[3]

IBM also appears to suggest that Section 204(b)(1)(H)(i) was intended to protect only those employees who have reached normal retirement age. Br. Opp. 4-5, 9-10 n.3. IBM made that argument below, but Judge Easterbrook ignored it and instead applied Section 204(b)(1)(H)(i) to workers of "any age," which is the term Congress used and which permits no limitation in coverage. This Court in *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996), in holding that Section 204(b)(1)(H)(i)'s had no retroactive effect, similarly did not limit its coverage to employees who have already reached normal retirement age. This Court's decision confirms what is clear on the face of the statute: Section 204(b)(1)(H)(i) applies to employees who have not attained normal retirement age. As Judge Scheindlin recently held, "[b]y its own terms, the ERISA age provision protects individuals of all ages." *In re Citigroup Pension Plan ERISA Litigation*, 2006 WL 3613691, at *10 (S.D.N.Y. Dec. 12, 2006) ("*Citicorp*").

Another disconnect between IBM's Brief in Opposition and Judge Easterbrook's opinion arises from their grasping for support from the Treasury Department for their misconstruction of Section 204(b)(1)(H)(i). The only authority cited by Judge Easterbrook for his treatment of cash balance plans as defined contribution plans is the

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[3] IBM's attempted analogies to savings accounts and social security benefits (pp. 1, 11) are clearly invalid. Unlike an employee under a cash balance plan, neither the owner of a savings account nor a social security beneficiary is immediately entitled to interest on his account balance through to normal retirement age. Instead, interest is credited to their accounts solely on a current, annual basis. *See*, in contrast, the Second Circuit's explanation in *Esden v. Bank of Boston*, 229 F.3d 154, 165-166 (2d Cir. 2000), of how an employee under the cash balance benefit formula is legally entitled to interest credits through to normal retirement age on every "contribution" to his account balance.

Treasury Department's proposed cash balance regulations which were never adopted because of Congressional opposition. Pet. App. 6. IBM ignores Judge Easterbrook's reliance on Treasury's proposed but withdrawn regulations, but instead cites one sentence from a 1991 preamble to regulations that did not even deal with age issues. Br. Opp. 9. Moreover, when those regulations were revised two years later, the new preamble did not include that sentence.[4] IBM made this argument below, but Judge Easterbrook ignored it.

B. Unable to defend Judge Easterbrook's opinion, IBM cites the Pension Protection Act of 2006, P.L. No. 109-280, 120 Stat. 780 ("PPA"), enacted a few days after the decision below, as supposedly legitimizing all cash balance plans. Despite months of intense lobbying by corporate sponsors of cash balance plans for retroactive authorization of their plans, Congress specifically refused to provide such immunity. The PPA expressly states that Congress did not intend this new prospective legislation to have any implications on the issue whether cash balance plans prior to the PPA violated Section 204(b)(1)(H)(i).[5] Moreover,

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[4] The regulations dealt with discrimination in favor of highly compensated employees and had nothing to do with age. When the EEOC objected to the preamble sentence because it pertained to age discrimination rather than tax qualification of defined benefit plans, the GAO investigated and reported that "[t]he agencies are continuing to analyze whether cash balance plans are age discriminatory. The continuing regulatory uncertainty surrounding cash balance plans, resulting in part from the preamble sentence, continues to be problematic for employers and plan participants." 7th Cir. Supplemental Appendix at SA-125. One of the leading pension legal scholars, Paul Strella, similarly rejected reliance on the preamble sentence because it was supported by "[n]o explanation, no analysis," was not included in a regulation, and was in a preamble to regulations that did not even deal with age discrimination. *Id.* at SA-72-73.

[5] Section 701(d)(1) of the PPA provides that:

> (d) No Inference. – Nothing in the amendments made by this section shall be construed to create an inference with respect to –

(Continued on following page)

Congress approved cash balance plans prospectively only if they satisfied provisions not found in prior law that protect older workers' benefits from benefit losses of the kind that plaintiffs challenged in this case, such as "wear-away" periods in which benefit accrual is suspended until the employee arrives at the same level of accrued benefits under the terms of the new plan as he had under the prior plan. Plaintiffs made such claims against IBM's Plan in this case, and they were settled for more than $300 million.

C. IBM's Brief in Opposition merely parrots Judge Easterbrook's conclusory holding that the rate of benefit accrual in cash balance plans is "age-neutral" because it depends "on the years the balance has been allowed to compound; age is not a factor." App. 10-11, *quoted* in Br. Opp. 10. Judge Scheindlin has demonstrated the fallacy in Judge Easterbrook's reasoning:

> Defendants also urge this Court to find that a "mere correlation" exists between reduced rates of accrual and older age, because any reduction in rates of benefit accrual is really a function of the time value of money. While this is a fair statement, it is inaccurate to the extent it assumes that the time value of money and age are mutually exclusive. Under a cash balance plan, employees never receive the amount in their hypothetical accounts as their retirement benefit. Instead, the cash balance in the account must be converted to the age 65 annuity. Because this actuarial conversion requires knowing an

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(1) the treatment of applicable defined benefit plans or conversions to applicable defined benefit plans under sections 204(b)(1)(H) of the Employee Retirement Income Security Act of 1974, 4(i)(1) of the Age Discrimination in Employment Act of 1967, and 411(b)(1)(H) of the Internal Revenue Code of 1986, as in effect before such amendments. . . .

> individual's age, cash balance plans are not age neutral. *Citicorp* at *13 (footnote omitted).

D. IBM's Brief in Opposition refuses to acknowledge the fundamental conflict between the Seventh Circuit in this case and the Second Circuit in *Esden* over the legal nature of cash balance plans. The Seventh Circuit treats such plans as variations of defined contribution plans and therefore focuses on the employee's current, albeit hypothetical, account balance. *Esden*, as well as the Ninth Circuit in *Miller*[6] and the Eleventh Circuit in *Lyons*,[7] focus instead on the accrued benefit in defined benefit plans, which is an annuity at normal retirement age. That this fundamental conceptual conflict controls the issue whether cash balance plans violate Section 204(b)(1)(H)(i) is demonstrated by Judge Scheindlin's recent decision in *Citicorp* in which she rejected the Seventh Circuit's approach in this case as contrary to the language and policy of the statute and followed *Esden*'s focus on the annuity at normal retirement age:

> Although other courts, including the Seventh Circuit, have treated cash balance plans as defined contribution plans for this purpose, doing so would ignore the plain language of the statute as well as the critical distinctions between the types of plans outlined by the Second Circuit in *Esden*. *Citicorp* at *11 (footnotes omitted).

Judge Scheindlin specifically rejected Judge Easterbrook's holding of statutory equivalence between Sections 204(b)(1)(H)(i) and 204(b)(2):

> Underlying [the Seventh Circuit's] interpretation is a presumption that Congress wrote "rate of benefit accrual" in one provision and "allocations

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[6] *Miller v. Xerox Corp. Retirement Income Guarantee Plan*, 464 F.3d 871 (9th Cir. 2006).

[7] *Lyons v. Georgia-Pacific Corp. Salaried Employees Retirement Plan*, 221 F.3d 1235 (11th Cir. 2000).

> to employee's account" in the other, but intended those phrases to say the same thing. Rules of construction preclude me from adopting this view. . . .
>
> As the Second Circuit has instructed, "[w]hen Congress uses particular language in one section of a statute and different language in another, we presume its word choice was intentional." If Congress had intended for "the rate of an employee's benefit accrual" to mean "the rate at which amounts are allocated to the employee's account," it would have copied those terms from the analogous provision.
>
> The other persuasive argument favoring plaintiffs' interpretation of the statute is ERISA's binary regulatory framework for defined contribution plans and defined benefit plans. This duality exists because defined contribution plans and defined benefit plans make categorically different promises to employees. As a result, the respective anti-discrimination provisions prescribe distinct metrics for detecting discrimination. Specifically, because employees with defined contribution plans are guaranteed employer contributions to retirement accounts but are not guaranteed a retirement benefit, discrimination is better discerned by looking at "the rate at which amounts are allocated to the employee's account." By contrast, because employees with defined benefit plans are guaranteed a retirement benefit ("output"), the sheer "*import* of the statutory language" connotes that "'rate of benefit accrual' refers to the outputs from the Plan." *Id.* at *11-12 (footnotes and citations omitted).

This conflict over the very nature of cash balance plans, of critical importance to millions of American workers, is sufficient to warrant granting the Petition. Indeed, Judge Easterbrook's statutory equivalence holding, which not even IBM can bring itself to defend, is of

paramount national importance in itself because, if unreviewed, it will distort regulation of defined benefit plans in general, not just cash balance plans.

II. IBM CONTENDS THAT YOUNGER WORKERS CAN BE GIVEN DISPROPORTIONATE BENEFIT INCREASES WITHOUT VIOLATING OLDER WORKERS' RIGHTS UNDER ERISA.

IBM admits that the purpose of the Always Cash Balance enhancement was to give proportionately larger benefits to younger workers under the new cash balance plan because the prior traditional defined benefit plan was more advantageous to older workers. Br. Opp. 12-13. IBM argues that as long as all workers with the same service and salary history are treated the same, there is no violation resulting from disproportionate benefit increases for younger workers with fewer years of service and smaller salaries. Neither Judge Easterbrook nor IBM has cited any authority permitting such favoritism toward younger workers. In fact, the Seventh Circuit settled this issue years ago by holding that older workers' rights are violated just as much by giving younger workers' disproportionately more benefits as by giving older workers less. *See Solon v. Gary Community School Corp.*, 180 F.3d 844, 853 (7th Cir. 1999).

IBM's claim that the ACB was age-neutral is false. While the discrimination may not be "facial," it was not far beneath the skin. IBM's actuary told management that older workers would receive only their already accrued benefits in their opening cash balance accounts, while younger workers would receive large unearned increases. Petition at 28. IBM does not deny these facts. The discrimination against older workers is just as clear as in *EEOC v. Jefferson County Sheriff's Dept.*, 467 F.3d 571, 579-580 (6th Cir. 2006) (*en banc*). There, as here, nothing was taken away from older workers, but younger workers

were given additional benefits. The Sixth Circuit ruled the plan clearly illegal because of its favoritism of younger workers; the Seventh Circuit upheld ACB here with no analysis.

IBM's contention that this issue is case-specific is incorrect. As *Jefferson County* demonstrates, favoritism toward younger workers in benefit plans can take many forms, but none is justified. The Seventh Circuit has now thrown that seemingly obvious conclusion into doubt.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

RICHARD J. LAZARUS
600 New Jersey Ave., N.W.
Washington, D.C. 20001

DOUGLAS R. SPRONG
STEVEN A. KATZ
KOREIN TILLERY, LLC
Gateway on the Mall
701 Market St., Suite 300
St. Louis, MO 63101

WILLIAM K. CARR
LAW OFFICES OF WILLIAM CARR
222 East Tennessee Ave.
Denver, CO 80209

LEE A. FREEMAN, JR.*
*Counsel of Record
JAMES T. MALYSIAK
FREEMAN, FREEMAN
& SALZMAN, P.C.
401 North Michigan Ave.
Suite 3200
Chicago, IL 60611
(312) 222-5100

ROBERT F. HILL
JOHN H. EVANS
HILL & ROBBINS, P.C.
100 Blake Street Building
1441 Eighteenth St.
Denver, CO 80202

Counsel for Petitioners

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